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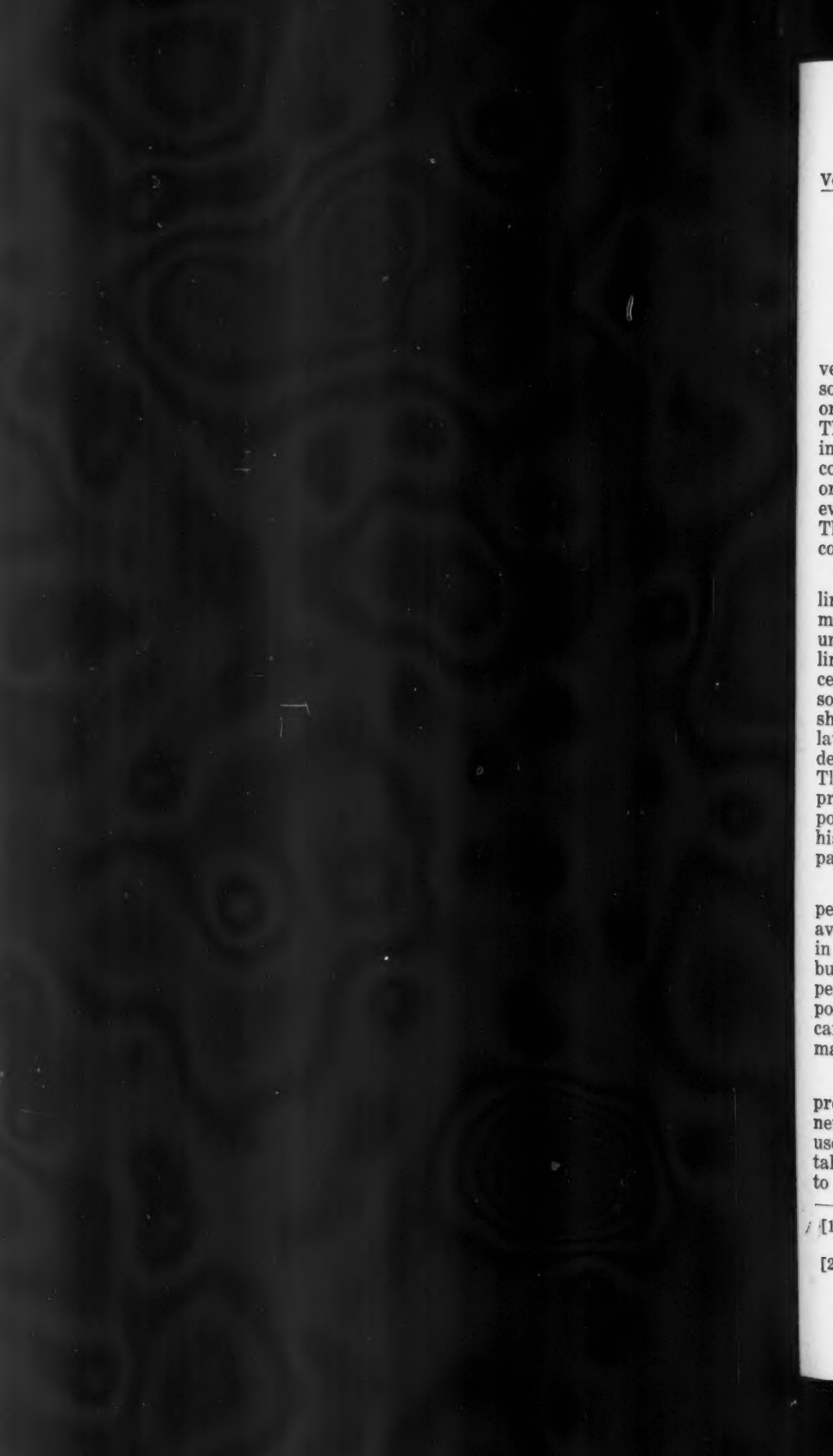

PARTNERSHIP OR COMPANY?

by

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When several persons join together to carry out a trade venture, the first problem they and their legal advisers must solve is whether the circumstances require that they should organize themselves in the form of a partnership or a company. This article will consider some of the features to be remembered in advising in such a situation. Taxation considerations, of course, play a very large part in determining what form of organization will be adopted. These considerations are, however, so numerous that they must be dealt with separately. This article will concern itself only with "non-taxation" considerations.

The first advantage that a company offers is, of course, limited liability. Indeed it is the traditional cause of the development of the joint stock company out of the old large and unwieldy partnerships. The risks run by an investor before limited liability was accepted about the middle of the last century are illustrated by a story told by Sir John Hollams, a solicitor at that time.[1] Sir John's client had taken a five pound share in a company which he later surrendered. Some years later the House of Lords held him personally liable for all the debts of this company amounting to eighty thousand pounds. The same situation can still arise today if the co-venturers prefer to organize in the form of a partnership. It is quite possible for a man to be ruined by the financial indiscretions of his partner, no matter what provisions are written into the partnership deed.

Of course, in those few cases where more than twenty people come together to carry out a venture, there is no choice available. The number of persons who can carry on a business in partnership is limited to twenty (ten in the case of a banking business) by the various Companies Acts.[2] If more than twenty people want to organize themselves together they must incorporate. A proprietary company is limited to fifty members. They can, of course, form an unlimited liability company which has many features in common with a partnership.

Limited partnerships introduced as a typical English compromise by the *Limited Partnerships Act* 1907 (Eng.) have never achieved popularity in this country. They are not much used in England either, as a limited partner is precluded from taking part in the management of the firm and has no power to bind it in any way. Some people may indeed regard this

[1] Quoted by Michael Birks in *Gentlemen of the Law*, Stevens, 1960, p. 218.

[2] N.S.W., s. 8; Vic., ss. 358, 359; Qld., s. 12; S.A., s. 9; W.A., s. 11; Tas., s. 10.

feature of partnerships as a drawback. In the absence of any provision to the contrary in the ordinary partnership deed, each partner is entitled to take part in the management of the business and to bind the firm. Members of a company have no power to act on its behalf.

A corollary to the limited liability of a company is its separate personality. The company is an entity separate from its corporators and its shareholders normally have no direct interest in or ownership of its property. This greatly facilitates the raising of capital and the securing of advances made to the company for its purposes by shareholders or others. It would no doubt be possible to devise some security over partnership assets (sometimes partly owned by the lender) to secure repayment of an advance, but a common form of equitable or floating charge over the company's assets in favour of a lender is much simpler with definite and clear-cut consequences in the event of a breach of the terms of that charge. Furthermore, an investor may well be prepared to take up preference shares in a company rather than to become a "sleeping partner", thus securing a limitation of his liability.

Another factor to be taken into account is control. This can be devised by careful drafting of either a partnership deed or a set of Articles of Association, but of the two, perhaps Articles of Association are more flexible. The general law of partnership contains many rules designed to safeguard the individual measure of control reserved to each partner. For example, unanimity is required if it is desired to add some other type of business to that for which provision is made in the partnership agreement. This flexibility in the nature of a business a partnership may carry on may be regarded by some as an advantage. For normal business decisions a majority will suffice, as also will a majority decision of directors. The question of expanding the range of activities of a company rarely arises today as the Memorandum is commonly drawn in very wide terms to assure all persons dealing with the company that its activities are within the scope of its authorized activities. The partnership deed may extend the unanimity rule even further. For example, employment of staff, trading policy, banking arrangements and other subjects may all be provided for in the deed with a provision that what has been laid down will not be altered except unanimously.

This can, however, become clumsy and unwieldy after a while. The more flexible structure of a company may be preferred. The Articles may provide for joint governing directors and, like the partnership deed contemplated above, may set out the specific matters on which unanimity is required in resolutions of directors. Alternatively, various classes of shares may be created (as many as there are co-venturers) and the rights of those classes set out in the Articles. This is preferable if there is not to be absolute equality among the co-venturers. Consideration might well be given to permitting the holder of each class of share to nominate himself or some other person as director, which director can then be removed only with his

consent. The ordinary rule is that the shareholders may in general meeting remove any director. This leaves a co-venturer who is a minority shareholder and director in a precarious position unless his tenure of office is secured in some way. Needless to say, there should be no provision for rotation and re-election of directors in such a company.

A corporation being a separate entity usually ensures more efficient management. In the first place it is not affected by changes in personnel. In the absence of special provision in a partnership agreement, a partnership is dissolved as regards all the partners by the death or bankruptcy of any partner[3] and the affairs of the partnership therefore have to be wound up. A company is not affected by the death or bankruptcy of a director except that he usually ceases to be a director. Because of its separateness, a company gives stability and continuity of policy and operations. Furthermore, a company is in a better position than a firm to encourage staff with profit sharing schemes. It can, for example, in New South Wales, issue workers' shares.[4] If a business wishes to introduce a new principal member it is more easily done with a company by the simple issue of shares. In the case of a partnership, the transfer of the interest of a retiring partner or the taking on of an additional partner involves the winding up of the original partnership and the creation of a new partnership.

A big drawback with companies is the difficulty of withdrawing capital once it has been subscribed. If a venture is to be of limited duration, there is no alternative to winding up if the capital is to be returned. No such difficulty exists in partnerships where assets are simply sold (or dealt with in any other way by agreement) and the proceeds divided among the partners according to their entitlement. Similarly, in the case of retirement or death, partnerships appear to have the merit of the balance of convenience. It is common to incorporate a compulsory purchase formula in a partnership deed in the event of the retirement or death of a partner. The formula is usually based on a capitalization of the earnings of the partnership over a certain period. Such an Article is less common. The common Article which provides that in the event of a shareholder wishing to sell his shares, he must first offer them to the other shareholders who may purchase them at their fair value may work hardship for three reasons. Firstly, the clause will have no application in the event of the death of a shareholder. Secondly, there is no compulsion on the other shareholders to buy. If there is no ready market for the shares the shareholder may suffer a substantial loss. Thirdly, the formula for arriving at a "fair value" unless set out with some precision may not include a taking into account of the dividend income of the shareholder which forms the real basis of valuation, so far as the shareholder is concerned.

[3] Partnership Acts N.S.W., 1892, s. 33; Vic., 1928, s. 37; Qld., 1891, s. 35; S.A., 1891-1935, s. 35; W.A., 1895, s. 44; Tas., 1891, s. 38 (1).

[4] (N.S.W.) Companies Act 1936-1960, ss. 165-168.

Finally the position of one's executor should be considered. An executor who carries on the business of a deceased partner is personally liable for all debts and obligations he incurs in carrying on that business. He is, of course, limited in his proper liabilities by the extent of the assets of the estate, but the extent of these liabilities is sometimes not easy to ascertain. An executor of a deceased director can easily ascertain the extent of his liabilities.

The question of partnership or company can only be resolved by the solicitor having regard to all material factors affecting the situation. There can be no one answer for all situations.

CASE NOTE

Governing Director as Servant of Company

Governing director—controlling shareholder in company—killed while piloting company's aircraft carrying out work of the company—could deceased be said to have been a servant of the company—whether a worker for the company.—The deceased was the governing director and controlling shareholder of a company formed for the purpose of conducting an aerial top-dressing business. The deceased was a qualified aircraft pilot and one of the Articles of Association of the company provided that the company should employ him as its chief pilot at a fixed salary from the date of incorporation of the company and that in respect of this employment, the rules of law applicable to the relationship of Master and Servant should apply.

Following the incorporation of the company, the deceased worked for it continuously as its pilot until his death, which occurred in an aircraft accident while engaged in aerial top-dressing operations for the company. In his capacity as governing director and controlling shareholder, the deceased had exercised full and unrestricted control over the affairs of the company, including the manner of employment of the company's aircraft and the methods employed in carrying out the work of the company. In an action for Workers' Compensation by his widow, the question arose whether the deceased was a "worker" within the *New Zealand Workers' Compensation Act* 1922 (as amended).

(Under the New Zealand Act, the term "worker" means "any person who has entered into or works under a contract of service or apprenticeship with an employer whether by way of manual labour, clerical work or otherwise and whether remunerated by wages, salary or otherwise".)

The Privy Council declared that the special position of the deceased as governing director did not prevent the creation of a contractual relationship between the deceased and the company and the range of possible contractual relationships included a contract for services and equally a contract of service.

Their Lordships rejected the argument that the deceased could not be both under the duty of giving orders and receiving them for they said it was the company and not the deceased who gave the orders, even though, so long as he continued to be governing director, he would be the agent of the company to give the orders. The company and the deceased were two separate and distinct legal persons and they were separate legal entities so as to enable the company to give orders to the deceased. The manner in which the company's right of control was exercised, viz., through the deceased, did not affect or diminish its right to exercise it.

The members of the Judicial Committee pointed out that there appeared to be no greater difficulty in holding that a man acting in one capacity could give orders to himself in another capacity than there was in holding that a man acting in one capacity could make a contract with himself in another capacity. It was never suggested that the company was a sham and once it was accepted that it was a legal entity there could be no reason to challenge the validity of any contractual obligations which were created between the company and the deceased. Nor could the capacity of the company to make a contract with the deceased be impugned, merely because the deceased had been the agent of the company in its negotiations.

Thus, there was no reason to doubt that a valid contractual relationship could be created between the company and the deceased and there was no reason why it should not take the form of a master and servant relationship. The right to control existed in the company, even though it was for the deceased in his capacity as agent for the company to decide what orders to give. Accordingly, there was a valid contract of service between the deceased and the company and the widow was entitled to Worker's Compensation under the Act.

Salomon v. *Salomon & Company,* [1897] A.C. 22 and *Commissioners of Inland Revenue* v. *Sanson,* [1921] 2 K.B. 492 applied. (*Catherine Lee* v. *Lee's Air Farming Limited,* [1960] 3 All E.R. 420.)

WESTERN AUSTRALIAN UNIFORM COMPANIES BILL

by

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The *Companies Bill* 1960 presently before the State Parliament is the Western Australian version of the Uniform Companies Bill agreed to by State and Commonwealth Ministers at conferences called to formulate uniformity in Company law throughout the Commonwealth.

The purpose of this article is to briefly inform practitioners of the more outstanding changes in the law which will ensue if and when the Bill becomes law in its present form. Except as regards the matters following, the Bill follows substantially the existing law.

Companies limited by guarantee (Cl. 14)

These will be new to Western Australia, although not to the other States where provision for them has existed for many years. For non-commercial associations this will offer a mode of incorporation alternative to the *Associations Incorporation Act* 1895.

Registration of Charges (Cl. 100, et seq.)

The Bills of Sale Act will no longer apply to securities given by companies. Instead, registration will have to be effected under the Companies Act. The procedure for registration will be similar to the present method of registering a debenture in the Bills of Sale Office. Actual registration will be effected by lodgment with the Registrar of Companies of the instrument of charge or a verified copy together with a statement of the prescribed particulars. The time for lodgment is within thirty days after the creation of the charge. Any charge not registered within the time is void without prejudice to the obligation of the company to pay the money secured, which then becomes immediately due and payable. Where failure to register within the time is due to accident, inadvertence or other sufficient cause, the court may extend the time. The definition of "charge" is wide enough to cover almost every kind of security which can be given by a company except mortgages solely over land. Even these have to be notified by the company to the Registrar although registration will continue to be effected at the Titles Office.

This generally has been the system of registration of company charges in the United Kingdom and in all the other States for many years past. The Bill will now bring Western Australia into line.

Ultra vires (Cl. 20)

The doctrine of *ultra vires* will no longer apply except in proceedings against the company by any member or debenture holder or by the company or any member against the present or former officers of the company or in any petition by the Minister to wind up the company. This, of course, is quite a departure from the existing law and it will be interesting to see how it will work.

Alteration of objects (Cl. 28)

A company will be able to alter its memorandum as to objects simply by special resolution. It will no longer be necessary to have the amendment confirmed by the court unless at least ten per cent in nominal value of the shareholders or debenture holders apply to have the alteration cancelled.

Reduction of capital by unlimited company (Cl. 64 (iii))

An unlimited company will be free to reduce its capital in any way without the necessity for confirmation by the court. As this will place an unlimited company in the same flexible position as regards capital as a partnership but with the advantage of corporate status it is probable that unlimited companies may at last be of some use. For the family investment type of company where limited liability is, in most cases, of no more than academic interest the unlimited company will offer interesting possibilities.

Resealing of probate (Cl. 95 (2))

Resealing of probate or letters of administration will no longer be necessary before a personal representative can transfer shares which are on the register of another State. An executor or administrator who has obtained a grant in another part of the Commonwealth will be able to transfer shares on a Western Australian register subject only to obtaining a certificate as to probate duty.

Abridged prospectus (Cl. 40)

This has been virtually abolished. Instead, every advertisement offering or "calling attention to an offer or intended offer" of shares in or debentures of a corporation will be deemed to be a prospectus unless it is confined to the following information:

(a) the number and description of the shares or debentures;
(b) the name, date of registration and paid up capital of the company;
(c) the general nature of the main business;
(d) the names of the directors and brokers or underwriters;
(e) the place where the full prospectus can be obtained.

No statement that the advertisement is not a prospectus will affect the operation of the Act. Radio and television advertising will also come within the above restriction.

Stock Exchange listing (Cl. 44)

Where a prospectus states or implies that Stock Exchange listing has been or will be applied for any allotment is void unless the shares are so listed within six weeks from the date of issue of the prospectus.

Official managers (Cl. 198)

The creditors of a company will be able to appoint an official manager. This will provide a method whereby creditors can get paid without liquidation.

Relief for minority shareholders (Cl. 186)

Any shareholder will be able to apply to the court on the ground that the affairs of the company are being conducted in a manner oppressive to some part of the members including himself. On such an application the court will have power to make such order as it thinks fit whether for regulating the conduct of the company's affairs in future or for the purchase of the shares of any members by other members or by the company.

Directors

Directors of public companies will have to retire at 72 years of age unless re-appointed by special resolution (Cl. 121).

A person who has been a director of a company which has been wound up and has paid its creditors less than ten shillings in the pound is made ineligible for five years to be a director or promoter or in any way concerned with the management of a company without the leave of the court (Cl. 122).

There will be a statutory requirement that a director "shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office" (Cl. 124 (i)).

There will also be a statutory prohibition against the improper use by any "officer" (which includes a director) of any information acquired by virtue of his position. He must not use such information to gain directly or indirectly an improper advantage for himself or cause detriment to the company (Cl. 124 (2)).

Loans to directors will be prohibited except in the case of an "exempt proprietary company" which is defined as a company in which none of the shares are held beneficially by or for another corporation (Cl. 125).

Banks and Life Assurance Companies

Section 5 of the existing Act excludes banks and life assurance companies from the operation of the Act. There is no similar provision in the Bill, consequently banks and life assurances will be obliged to register and conform to the new Act in the same way as other companies. There is no hardship in this except that the fees for registration will be sharply increased and registration of a company whose nominal capital runs into millions will be a comparatively expensive business.

Fees (2nd Schedule)

This brings us to the matter of the fees proposed by the Bill. The fee for registration of a company is £20 where the nominal capital does not exceed £5,000. Thereafter, it increases by £1 per £1,000 up to £100,000, then by 10/- per £100,000 up to £500,000, with 5/- per £1,000 thereafter. Examples of the proposed fees are as follows:

Nominal Capital	Registration Fee
£100,000	£115
500,000	315
1,000,000	440
10,000,000	2,690
20,000,000	5,190

For registration of a foreign company the fees are the same as for a local company but where the prescribed fee is inapplicable, the fee will be £100.

All other fees payable to the Registrar will be substantially increased. For example, the search fee for availability of a name will be 10/- and for lodging a prospectus will be £5.

Names of Companies (Cl. 22)

The long list of prohibitions on the use of certain names or words in names of companies will cease to apply. Instead, the Bill provides that except with the consent of the Minister a company shall not be registered by a name that, in the opinion of the Registrar, is undesirable, or is a name, or a name of a kind, that the Minister has directed the Registrar not to accept for registration. The Minister is to cause a direction to be published in the Gazette and presumably this will contain a usual list of prohibited words such as "Crown", "State", "Royal", etc. Opinions as to undesirability will always vary and students of administrative law may see a retrograde step in this change in the law.

The Australian Lawyer, April, 1961.

PERSONAL LIABILITY OF DIRECTORS FOR COMPANY DEBTS

by

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Section 281 (1) of the *Companies Act* 1943 of Western Australia provides that—"If in the course of winding up it appears that the business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the Court, on the application of the liquidator or any creditor or contributory of the company, may if it thinks proper so to do declare that any directors, whether past or present, of the company who were knowingly parties to the carrying on of the business in the manner aforesaid shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the Court directs."

The Companies Acts of the United Kingdom, New Zealand and the other Australian States contain substantially the same provisions.[1] One important variation in the United Kingdom, New Zealand, Victorian and Tasmanian sections is that liability is not limited to "directors past or present" but extends to "any persons knowingly parties" to the carrying on of the business of a company in the manner indicated.*

The section was originally introduced in the English Companies Act of 1929, and had the general objective of making company directors personally liable to creditors of the company when the former had been found guilty of fraudulent trading. In particular the provision was to apply to the case of a single person who controls a private company and has a floating charge over the assets of the company, and who, when he realizes that the company is facing ruin, obtains goods on credit which automatically become subject to his charge.

Additionally, by subsection (2), the court is given a discretion to make the liability of such a director a charge on any debt or obligation due from the company to him. Furthermore, by subsection (3), the director is liable to a criminal prosecution on indictment, and, on conviction, is liable to a term of imprisonment of up to one year.

Under the English Act a declaration pursuant to subsection (1) is regarded as a final judgment for purposes of bankruptcy proceedings. No such provision has been incorporated into the State Acts (other than in Western Australia), presumably due to the fact that the Commonwealth Parliament has seen fit to exercise its powers in relation to bankruptcy.

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* This variation is embodied in s. 304 (1) of the proposed new Uniform Companies Act.—Ed.

[1] Companies Act (U.K.) 1947, s. 101; Companies Act (N.S.W.) 1936-37, s. 307; Companies Act (Vic.) 1958, s. 226; Companies Act (S.A.) 1934-35, s. 290; Companies Act (Q'land) 1931, s. 284; Companies Act (Tas.) 1959, s. 237; Companies Act (N.Z.) 1955, s. 320.

Shortly after the introduction of the section to the English Act difficulties in its interpretation became apparent. The learned authors of the eleventh edition of *Buckley*[2] highlighted several difficulties in its interpretation. What constituted the somewhat defined offence was a matter for conjecture. Once the court made a declaration that a director was to be subject to personal liability, then to what extent should he be declared liable, and to what creditors should he be so liable? Was it the intention of the legislature that he should be directly liable to the creditors subjected to the fraud, whereby they would recover the full amount of their credit, meanwhile leaving the others, and the costs of winding up, unpaid? On the other hand, was the director to be liable to the company as a whole for these amounts, whereby all unsecured creditors would obtain some contribution as in a winding up?

MAUGHAM, J., as he then was, was soon to pronounce upon some of these important questions, in two liquidators' applications under the English section. The first of these was in *Re William C. Leitch Bros. No.* 1.[3] In this application a company, of which the respondent was managing director, had been financially embarrassed over a period and by March 1930 became unable to pay its debts. It owed £6,500 for goods supplied, which, to the knowledge of the respondent, it had no hope of paying. The respondent held shares in the company and also a £4,000 debenture, secured by a charge on all the property of the company. After 1 March 1930 the respondent ordered £6,000 of goods (an amount in excess of the company's needs at the best of times) which immediately became subject to his charge. The liquidator sought an order under s. 275 (1) *Companies Act* 1929, that the respondent be made personally liable for *all* of the company's debts and other liabilities.

In deciding to make an order for personal liability, MAUGHAM, J., said:—"In my opinion, I must hold with regard to the meaning of the phrase carrying on business 'with intent to defraud creditors' that, if a company continues to carry on business and incur debts at a time when there is, to the knowledge of the directors, no reasonable prospect of the creditors ever receiving payment of those debts, it is in general a proper inference that the company is carrying on business with intent to defraud. As I have intimated, I am satisfied that the respondent knew what the position was from March 1930, and I hold further that the respondent deliberately went on trading in the name of the company in order, as he hoped, to safeguard his own position and without any regard to the interests of the creditors."[4]

The learned judge then discusses the problems consequent to the making of such an order. He examines the section and concludes that it is a punitive provision and, therefore, where a court makes a declaration in relation to all or any of the company's debts it is in the discretion of the court to make an

[2] *Buckley*, 11th ed., at pp. 564-5.
[3] [1932] 2 Ch. 71; [1932] All E.R. Rep. 892.
[4] [1932] 2 Ch. 71 at p. 77; [1932] All E.R. Rep. 892 at p. 895.

order without limiting it to the amount of the debts of those creditors proved to have been defrauded, though, no doubt, the order would in general be so limited—and was in fact so limited in this application.

The question of how the moneys, the subject of the order, should be distributed was subsequently settled by EVE, J., in *Re William C. Leitch Bros. Ltd. No. 2.*[5] It was here ordered that all the moneys recovered by the liquidator, pursuant to such a declaration should be dealt with as general assets and applied accordingly.

In the second application, *Re Patrick and Lyon Ltd.*,[6] MAUGHAM, J., in reaching his conclusion, placed marked emphasis on the words "defraud" and "fraudulent purpose" as used in s. 275 of the English Act. They are words, he said, "which connote actual dishonesty involving, according to current notions of fair trading among commercial men, real moral blame".[7]

The history of the company in question was one of commercial failure, and, sometime after this state of affairs became apparent, the respondent purchased four debentures in the company and continued to carry on business operations. Ultimately the company was wound up and an application made for a declaration of unlimited liability for the company's debts against the respondent.

In exercising his jurisdiction under this section, MAUGHAM, J., held it to be necessary for the court to consider whether the director "has been guilty of dishonest fraud",[8] and the onus of proving this charge naturally rests on the applicant. The learned judge refused to make an order on this application, the distinguishing fact being that "the business of the company . . . was carried on in order to clear up the position by getting in debts and by effecting sales of stock and not with a view to securing purchases on credit assets available for security for debentures".[9]

Although the results of these applications may be reconciled on the facts, it is submitted that it is apparent that MAUGHAM, J., altered his ground and in the latter application substantially modified the purely objective test prescribed in the former—he places more emphasis on the objects of the director involved.

However satisfactory these rulings have been regarded in English company law, substantial doubt has been cast upon their efficacy so far as the interpretation of the Australian counterpart sections is concerned. These doubts have been engendered by the recent decision of the High Court of Australia in *Hardie* v. *Hanson*,[10] when it considered an appeal from an

[5] [1933] Ch. 261; [1932] All E.R. Rep. 897.
[6] [1933] Ch. 786; [1933] All E.R. Rep. 590.
[7] [1933] Ch. 786 at p. 790; [1933] All E.R. Rep. 590 at p. 593.
[8] [1933] Ch. 786 at p. 791; [1933] All E.R. Rep. 590 at p. 593.
[9] [1933] Ch. 786 at p. 792; [1933] All E.R. Rep. 590 at p. 594.
[10] [1960] A.L.R. 209.

order made by VIRTUE, J., under s. 281 of the Companies Act (W.A.). The High Court has reconsidered the section and the trend noticeable in MAUGHAM, J.'s latter judgment is carried considerably further and the *intention* of the director concerned becomes the paramount consideration.

The facts in *Hardie's Case* are similar to those in *Re Patrick and Lyon*.[11] In May 1956 the appellant established the company of Hardies and Thomsons Pty. Ltd. for the purpose of selling electrical equipment and radios. The company traded unsuccessfully and went into voluntary liquidation in May 1958. In December 1956 the appellant borrowed £6,000 which he paid into the company's account to reduce its overdraft. From February 1957 until March 1958 the appellant withdrew from the company approximately £5,800 for private purposes, but during the same period he paid to the credit of its account a sum of at least £3,832, after realizing certain of his own assets. It was the appellant's practice to draw upon the company to discharge his own debts and his account would be debited with the amount of his drawings. At the date of winding up, the company had debts totalling £35,000 compared with £34,261 the year before.

VIRTUE, J., was satisfied that the business of the company had been carried on with intent to defraud the creditors and he held Hardie responsible, without limitation, to the extent of £1,500. He found that to the knowledge of the appellant the company was trading unsuccessfully, that it was unable to pay its creditors, and doubted Hardie's belief in the future of the company or its ability to make good. These factors, together with the overdrawing of accounts (the latter in particular), enabled His Honour to find dishonest fraud.

The High Court, consisting of DIXON, C.J., KITTO and MENZIES, JJ., unanimously upheld Hardie's appeal. Before an order can be made under s. 281 (1) three conditions must be satisfied[12]:—

(a) That business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose;

(b) it must appear that a director or directors, whether past or present, were knowingly parties to the carrying on of the business in the manner aforesaid;

(c) if (a) and (b) are fulfilled the court may, if it thinks proper to do so, make an order—i.e., there is a discretion in the court.

It is incumbent on the applicant (usually, but not necessarily, the liquidator) to satisfactorily establish an intention to defraud, and that intention "must be express or actual and real: nothing constructive or implied will do".[13] There must be "an actual purpose, consciously pursued, of swindling creditors out of their money".[14]

[11] p. 60, *supra*.
[12] Dixon, C.J., at [1960] A.L.R., pp. 211-212.
[13] Per Dixon, C.J., at [1960] A.L.R., p. 212.
[14] Per Kitto, J., at [1960] A.L.R., p. 216.

The principle laid down by MAUGHAM, J., in *Re William C. Leitch Bros. Ltd.*[15] has been substantially undermined. That the carrying on of a business with the knowledge that there was no reasonable prospect of the creditors ever receiving payment should amount to an intention to defraud, within the meaning of s. 281, was discounted as a relic of too close an association with similarly phrased sections in bankruptcy legislation, an association for which there is no scope in Australia. Protection is extended to the naive director who carried on business at all costs in a final effort to restore his company to buoyancy, no matter how optimistic he may be or how honest is his belief that a restoration is possible.

"The question is not whether he dealt in all respects honestly with the situation or with all the creditors or other persons involved. The question is whether he carried on business . . . with intent to defraud creditors."[16]

Once again one must revert to those fundamental words of subsection (1), "with intent to defraud". The time during which a director may, with impunity, carry on trading when his company is in an irretrievable economic decline is a question of fact to be determined in each application. It would be impossible to categorically define the activities which would render a director subject to an order under s. 281 (1). Perhaps MENZIES, J., goes closest to providing a definition when he says:—"The degree of fault depends upon the buyer's estimate of the probability or improbability of payment at the time when the goods were purchased, but even if the chance of payment of all creditors in full was so remote that it belonged to the realms of hope rather than belief, it seems to be that the fault, grievous though it may be, falls short of fraud unless it is coupled with something else, such as misrepresentation of the position or an intention to use goods purchased on credit for the purposes of dishonest gain, which gives it a fraudulent character."[17]

Undoubtedly the section is directed primarily at the director, who, having a charge over company assets and realizing the company's hopeless financial position, procures goods which automatically become subject to his charge. Hence the provisions in subsection (2). On this basis it is submitted that the ultimate result in *Re William C. Leitch Bros. Ltd.* is reconcilable with that in *Hardie's Case*, although MAUGHAM, J.'s reasoning can no longer be regarded as authoritative in Australia.

Although Hardie considerably overdrew on his account, he made large payments into the company accounts from his personal assets, and this action was an important factor in establishing his intentions when considering his conduct towards the company's creditors, and the fact that he carried on the business long after it was economically expedient to do so.

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[15] [1932] 2 Ch. 71 at p. 77; [1932] All E.R. Rep. 892 at p. 895, p. 3 *supra*.

[16] Dixon, C.J. at [1960] A.L.R., p. 214.

[17] Menzies, J., at [1960] A.L.R., p. 218.

Now that the High Court has made an authoritative ruling on the construction of s. 281 (1) of the *Companies Act* 1943 (W.A.), the difficulty of obtaining an order of unlimited liability for the benefit of the creditors has become obvious. To obtain such an order it has become imperative that the applicant establish the requisite intention to defraud. The proof of intention in this situation may be likened to the establishment of *mens rea* in a criminal trial. It is submitted that the obligation to prove intent weighs equally heavily on the applicant seeking an order under subsection (1) as on the prosecution seeking a conviction under subsection (3).

Assuming that an order is made against a director for unlimited liability, to whom should the benefit of the order be directed? EVE, J., in *Re William C. Leitch Bros. Ltd. No.* 2,[18] ruled that the money subject to the order should be distributed as on a winding up. Doubt has been cast upon this ruling by the Chief Justice and MENZIES, J., in *Hardie* v. *Hanson*, although it was unnecessary for them to consider the point. MENZIES, J., reiterated an opinion of long standing, expressed in a work of which he was joint author,[19] namely, that a declaration should be made rendering the director personally liable to the specific creditors who were so defrauded as to form the basis of the declaration. His Honour points out, however, that in construing the Western Australian section it must be remembered that it was adopted in substantially the same terms as its English counterpart at a time after EVE, J., had given the section his interpretation.

If s. 281 of the *Companies Act* 1943 (W.A.) and its counterparts have been of limited popularity with company liquidators, one may be excused from observing that they might be well justified in distributing such assets as have been recovered rather than risking them on legal costs, when one takes into account the uncertainties of the section and, in particular, the difficulty of establishing fraudulent intentions to delinquent directors.

[18] [1932] All E.R. Rep. 892 at p. 898.

[19] O'Dowd and Menzies *Victorian Company Law* (1940), at p. 481.

TWELFTH LEGAL CONVENTION

The Twelfth Legal Convention will be held in Sydney, commencing on Wednesday, 5 July, 1961, and ending with the Convention Dinner on Tuesday, 11 July, 1961.

The papers on the topics mentioned in the tentative programme will be printed and distributed in advance to those attending the Convention. At the Convention each author will introduce and read his paper. The paper will then be discussed and at the conclusion the author will reply.

Guests and visitors from abroad will include the Lord Chief Justice of England and Lady Parker, and it is hoped a distinguished Justice from the United States. Invitations are also being issued to certain distinguished Judges and members of the profession from Canada, South-East Asia and Africa. A general invitation is being issued to the Judges and legal profession of New Zealand to attend on the same basis as Australian delegates.

There will be entertainments and trips on every day and on the Saturday and Sunday, and (if there is enough support) trips after the Convention to such places as:—

(a) the North Coast of New South Wales (a rich timber-getting, cattle and dairying district), including holiday resorts, Hunter Valley vineyards and Newcastle.

(b) Canberra and the Australian Capital Territory, and

(c) the Snowy Mountains (the great hydro-electric scheme, snow sports, mountain scenery)

for those who wish to see something of other parts of New South Wales and the Australian Capital Territory.

Any delegate wishing to arrange tours to places other than those mentioned may do so. Arrangements are being made to appoint a travel agent to advise delegates.

A circular giving details of the programme has already been sent to all Lawyers.

[This note was supplied by courtesy of

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